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OFFICE OF THE SECRETARY

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February 14, 2000

EX PARTE OR LATE FILED

Magalie Roman Salas, Secretary
Federal Communications Commission
Room TW-A325
445 Twelfth Street, S.W.
Washington, D.C. 20554

Re: Ex Parte

Applications for Consent to the Transfer of Control
of Licenses and Section 214 Authorizations from U S
WEST, Inc., Transferor, to Qwest Communications
International Inc., Transferee, CC Docket No. 99-272

Dear Ms. Salas:

On February 11, 2000, Robert A. McCausland of Allegiance Telecom, Inc. (Allegiance), A. Richard Metzger, Jr. of Lawler Metzger & Milkman, LLC, counsel to Allegiance, Randall Rings and Stacey Stewart of McLeodUSA Telecommunications Services, Inc. (McLeodUSA) and I, on behalf of McLeodUSA, held separate meetings with Jordan Goldstein, legal advisor to Commissioner Susan Ness, and Sarah Whitesell, legal advisor to Commissioner Gloria Tristani, to discuss the above-referenced proceeding.

During each meeting, representatives of McLeodUSA and Allegiance explained why it is necessary for the Commission to impose conditions on any approval of the transaction. In particular, McLeodUSA and Allegiance emphasized the need for conditions designed to ensure the merged company's compliance with the key market-opening requirements of the Communications Act of 1934, as amended:

- U S WEST Inc. (U S WEST) has routinely failed to comply with the requirements of Section 251. For example, U S WEST has repeatedly placed unreasonable and discriminatory conditions on the resale of its local services in violation of Section

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251(c)(4).¹ U S WEST has refused to provide McLeodUSA with nondiscriminatory access to its operations support systems in violation of Sections 251(c)(3) and 251(c)(4).² U S WEST has refused to provide McLeodUSA with collocation on just and reasonable terms and conditions in violation of Section 251(c)(6).³ U S WEST is also in violation of the more general requirement to maintain adequate service quality as evidenced by the authority in Section 214(d) and its state law counterparts.

- The proposed transaction will make this already unacceptable situation worse because it will increase the incentives of the U S WEST ILECs to discriminate against competitors.⁴ The U S WEST ILECs currently do not have a strong incentive to degrade unaffiliated carriers' terminating access service because the ILECs do not terminate interLATA traffic carried by an affiliated carrier. With the addition of Qwest Communications International Inc. (Qwest), the U S WEST ILECs will suddenly be able to capture the benefits of providing terminating service to their affiliated long distance carrier on preferential terms. Furthermore, the merger will increase U S WEST's incentive to preserve its control over bottleneck termination facilities. This is because retaining those bottleneck facilities will allow U S WEST to discriminate in favor of the Qwest long distance business. The cheapest way for U S WEST to preserve its control over bottleneck terminating facilities is to degrade the wholesale inputs it provides to CLECs such as Allegiance and McLeodUSA.
- In addition, the proposed transaction will give U S WEST new opportunities to divert resources away from its wholesale ILEC

¹ See Letter from Philip L. Verveer to Ms. Magalie Roman Salas, CC Docket No. 99-272 at 2-3 (Jan. 13, 2000) ("McLeodUSA Jan. 13, 2000 Ex Parte").

² See id. at 3-6.

³ See id. at 6-8.

⁴ See Bridger M. Mitchell, "Report On Some Anticompetitive Aspects Of The Proposed Merger Of Qwest And U S WEST" at 9-11 (Dec. 20, 1999) ("Mitchell Report"), attached to the McLeodUSA Jan. 13, 2000 Ex Parte.

operations.⁵ As a result of their affiliation with Qwest, the U S WEST ILECs will suddenly have the opportunity to invest money in Qwest's networks in Europe, Mexico, and in the U.S. outside of the U S WEST region as well as in undersea cables. Starving the ILEC wholesale operations and funding the new Qwest businesses is a win-win for the combined firm. First, competitive entry will be largely prevented, thus preserving margins in the ILEC business. Second, inexpensive capital will be freed up for investment in the Qwest global networks. The Commission cannot allow this result. Investment in non-jurisdictional assets cannot be tolerated where the ILEC in question has failed first to allocate the resources necessary to comply with the requirements of Sections 251-252.

- Furthermore, the proposed transaction will likely reduce the ability of regulators to detect the diversion of resources away from the U S WEST ILECs.⁶ The addition of Qwest to U S WEST will quickly and dramatically increase the complexity and scope of the businesses with which the U S WEST ILECs are affiliated. As a result, it will be much more difficult for regulators to determine whether money has been misallocated away from the regulated ILEC businesses and toward unregulated businesses.
- It is also simply untrue that these harmful effects will be offset by the combined firm's increased incentive to comply with Sections 251-252 in order to receive Section 271 approval.⁷ U S WEST and Qwest have claimed that the merged firm would have a strong incentive to enter the in-region interLATA market because the in-region Qwest assets are "sunk." That is, U S WEST and Qwest have essentially claimed that those assets⁸ can only be used to provide interLATA service by the merged firm.⁸ But U S WEST and Qwest have not and cannot point to any factor that would preclude a different carrier from using the assets in question to

⁵ See id. at 8-9.

⁶ See id. at 6-8.

⁷ See id. at 11-13.

⁸ See Declaration of Bruce Owen at 9, Attachment B to Qwest and U S WEST's "Response to Comments on Applications for Transfer of Control," CC Docket No. 99-272 (Oct. 18, 1999).

Magalie Roman Salas, Secretary
February 14, 2000
Page 4

provide service.⁹ The merged firm would therefore consider the sale price of the Qwest in-region assets as an opportunity cost in its assessment of whether Section 271 approval should be pursued. This cost, when added to the otherwise high cost (both in terms of investment and loss of market share) associated with Section 271 compliance, will almost certainly cause the merged firm to continue to forego any effort to comply with Section 271 that is sufficiently serious to overbalance the harms caused by the merger.

- Finally, during the meeting, representatives from McLeodUSA described discussions between senior executives at both McLeodUSA and Qwest that implicate Section 271 and the Commission's review of the instant transaction. As discussed more fully in a separate ex parte filed by McLeodUSA today in the above-referenced docket (attached hereto along with supporting affidavits as an exhibit), during the discussions at issue, Qwest executives indicated that Qwest wants to sell its Section 271-related assets to a "friendly" buyer from whom it can reacquire those assets in the future and that Qwest did not consider McLeodUSA a friendly buyer.

Pursuant to Section 1.1206(b)(1) of the Commission's rules, 47 C.F.R. § 1.1206(b)(1), an original and one copy of this letter and attachments are being provided for inclusion in the public record of the above-referenced proceeding.

Sincerely,


Philip L. Verveer


Attachments

cc: Jordan Goldstein
Sarah Whitesell
Service list

⁹ See Mitchell Report at 12.

CERTIFICATE OF SERVICE

I, Carmen D. Minor, do hereby certify that on this 14th day of February, 2000, I have caused a copy of the foregoing ***Ex Parte*** filing to be served, via hand delivery or first class United States Mail, postage prepaid, upon the persons listed on the attached service list.



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WEST, Inc., Transferor, to Qwest Communications
International Inc., Transferee, CC Docket No. 99-272

Dear Ms. Salas:

On February 11, 2000, Randall Rings and Stacey Stewart of McLeodUSA Telecommunications Services, Inc. (McLeodUSA) and I met with James R. Bird, and Paula Silberthau of the Office of General Counsel and Robert C. Atkinson, Donald K. Stockdale, Margaret Egler and Henry Thaggert of the Common Carrier Bureau. During the meeting we discussed the divestiture required to bring Qwest Communications International Inc. (Qwest) into compliance with Section 271 of the Communications Act in the event that it proceeds with the transaction proposed in the above-referenced applications.

More specifically, we described communications that McLeodUSA received from Qwest executives on February 9, 2000 that bear upon the divestiture. The substantive elements of the communications are set forth in the affidavits of Blake Fisher and Scott Cate, copies of which are appended hereto as Exhibits A and B respectively (originals will be filed with the Commission promptly). The affidavits describe conversations with senior Qwest executives that disclosed Qwest's desire to sell the 271-implicated assets to a friendly buyer so the assets could be reacquired in the future and Qwest's unwillingness to consider McLeodUSA as a buyer of the assets unless and until McLeodUSA withdrew its opposition to the merger.

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Magalie Roman Salas, Secretary
February 14, 2000
Page 2

Individually and together, the affidavits pose several very troubling questions. First, Qwest's desire to exclude McLeodUSA (and perhaps other potential buyers perceived as unfriendly) would raise serious issues even considered in a vacuum. It is unclear why any entity attempting a clean divestiture would exclude any qualified buyer, since to do so risks a lower price. Of course, if Qwest is netting out the sales price of the assets against the cost to Qwest of increased competition, it may be rational to exclude some or all of the competitors that Qwest believes may be particularly effective. That type of calculation only underscores the extraordinarily provocative nature of the proposed merger, uniting as it would an incumbent local exchange company with a significant interexchange company. A divestiture rigged to steer the assets away from strong competitors cannot be considered a positive in the balance of the positive and negative effects of the proposed merger.

Second, there is probable cause to suspect that a great deal more is taking place. An effort to park the assets for later reacquisition bears upon both compliance with the requirements of Section 271 and the extent to which the Commission should rely upon Qwest's claims of increased incentives to meet the checklist and other 271 requirements (and thus improve wholesale quality of service) to overbalance the negative effects of the merger. If the divestiture is supposed to result in no diminution in Qwest's incentive to secure Section 271 approvals, McLeodUSA submits that a sale subject to an explicit or implicit parking arrangement fails to meet the requirement.

The actual consequences of such an arrangement are of course derivative of factual details regarding the divestiture that are not currently available. The Commission must take seriously, however, the possibility that the sale of the Qwest Section 271 assets to a friendly buyer would allow U S WEST, Inc. (U S WEST) to participate in the in-region interLATA business prior to receiving Section 271 approval. This was of course exactly the concern that caused the Commission to declare the U S WEST/Qwest joint marketing arrangement unlawful under Section 271. See AT&T v. Ameritech et al, 13 FCC Rcd 21438 (1998) aff'd U S WEST Communications, Inc. v. FCC, 177 F.3d 1057 (D.C. Cir. 1999). Placing long distance customers in the hands of a "friendly" third party would also give the U S WEST ILECs the incentive to discriminate in favor of the third party in violation of Section 251 (and of course the Section 271 checklist). In addition, such an arrangement could insulate a segment of the market from competitive providers of long distance service since the customers would be essentially held in trust for Qwest/U S WEST.

Magalie Roman Salas, Secretary
February 14, 2000
Page 3

This effect would diminish further the merged firm's incentive to comply with Section 271 since Qwest/U S WEST would be less concerned that competing providers of bundled services such as McLeodUSA could win those customers before the merged firm receives Section 271 approval.

Third, there is something profoundly offensive to the ethos of public regulation in Qwest's effort to coerce McLeodUSA into dropping its advocacy of conditions designed to prevent yet further deterioration in U S WEST's wholesale service quality as a result of the merger. The Communications Act and many of its state counterparts are designed to accommodate broad participation in matters such as the Qwest-U S WEST transaction. One of the principal motifs of administrative law is that important decisions will benefit qualitatively from full participation by anyone with something to contribute. An effort to induce McLeodUSA to abandon its participation is an effort to deprive the process and the decisionmakers of information and perspectives that should, by the basic assumptions of administrative law, lead to a better decision.

Pursuant to Section 1.1206(b)(1) of the Commission's rules, 47 C.F.R. § 1.1206(b)(1), an original and one copy of this letter and attachments are being provided for inclusion in the public record of the above-referenced proceeding.

Sincerely,


Philip L. Verveer

Attachments

cc: James R. Bird
Paula Silberthau
Robert C. Atkinson
Donald K. Stockdale
Margaret Egler
Henry Thaggert

A

AFFIDAVIT OF BLAKE FISHER

STATE OF UTAH

COUNTY OF SALT LAKE

Blake Fisher, being just duly sworn on oath, deposes and states as follows:

1. I am a Group Vice President of McLeodUSA, with responsibility for the planning and development of the company's network. I am also a member of the Board of Directors, and a former Chief Financial Officer of the company. I am over 21 years of age and believe in the obligations of an oath.
2. As part of my normal course of business, on Wednesday, February 9, 2000, I was speaking on the telephone with my colleague from McLeodUSA, Mr. Scott Cate, Group Vice President in charge of the long distance product, and also with Messrs. Greg Casey, Executive Vice President and Wisenberg (not sure of spelling), Vice President, senior executives with responsibility for wholesale operations and strategic relationships, respectively, at Qwest.
3. In the course of the conversation, I mentioned that Mr. Cate and others were about to travel to a meeting at Qwest to discuss the possibility of McLeodUSA purchasing the assets that Qwest is divesting pursuant to its Divestiture Plan filed with the FCC (to discharge its obligations under section 271 of the Telecommunications Act of 1996 so it can complete its acquisition of US West.) Mr. Casey stated that "we don't think it makes much sense for McLeodUSA to come to Qwest to inspect the Divestiture Assets because Qwest wants to work with a friendly party and enter into certain co-

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marketing and co-sourcing arrangements." It was clear to me that Mr. Casey was implying that Qwest would likely require any buyer of the Divestiture Assets to purchase billing and other services from Qwest.

4. Mr. Casey continued, "Given McLeodUSA's opposition to Qwest's merger at the FCC and at various state public utility commissions, we [Qwest] won't make ourselves available to McLeodUSA employees or sign a confidentiality agreement allowing McLeodUSA to participate in the auction for the Divestiture Assets unless McLeodUSA drops its opposition to the merger."
5. Mr. Casey continued that McLeodUSA "would be a good choice to buy the assets" except that Qwest management felt that it could not enter into the type of co-marketing or co-sourcing agreements it was contemplating with McLeodUSA since it was opposing the merger at the FCC and at various state public utility commissions. Mr. Casey continued that Qwest would seriously consider negotiating with McLeodUSA to sell the Divestiture Plan assets to McLeodUSA, if McLeodUSA should drop its opposition to the Qwest/US West merger. If not, then McLeodUSA was instructed to return the information package on the Divestiture Assets which it had already received.

FURTHER AFFIANT SAYETH NOT

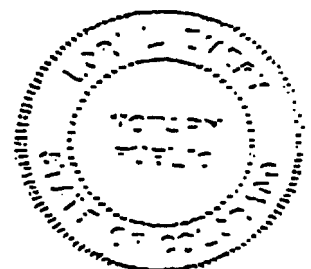


Blake Fisher

Subscribed and Sworn To before me this the 14th day of February, 2000.



Lori L. Emery
My Commission Expires
July 1, 2003



B

Affidavit of Scott Cate

STATE OF UTAH

COUNTY OF SALT LAKE

SCOTT F. CATE, being just duly sworn on oath, deposes and states as follows:

1. I am a Group Vice President of McLeodUSA, with responsibility for the company's long distance product. I am over 21 years of age and believe in the obligations of an oath.
2. As part of my normal course of business, on Wednesday, February 9, 2000, at approximately 10:00 AM, I was speaking on the telephone with Mr. James Shearburn, a Regional Vice President for Qwest.
3. In the course of the conversation, I mentioned that I was about to travel to another meeting with colleagues of Mr. Shearburn's, to discuss the possibility of McLeodUSA purchasing the assets that Qwest is divesting pursuant to its Divestiture Plan filed with the FCC, to discharge its obligations under section 271 of the Telecommunications Act of 1996 so it can complete its acquisition of US West.
4. Mr. Shearburn picked up on that, and stated to me that McLeodUSA "would be perfect for that [to buy the assets]" except that Qwest management was angry at McLeodUSA for objecting to the merger at various state public utility commissions. He stated that McLeodUSA "is not making the [Qwest] top brass happy."
5. Mr. Shearburn continued that Qwest would really like to sell the Divestiture Plan assets to a "friend", "so that we can buy them back later." Mr. Shearburn continued, that

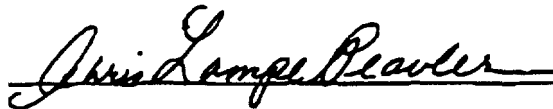
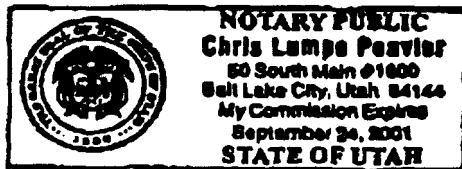
McLeodUSA's objections to the Qwest/US West merger would deem McLeodUSA not a "friend" who could be counted upon to later sell back the Divestiture Plan assets to Qwest, so that Qwest would therefore probably not sell the assets to McLeodUSA in the first place.

FURTHER AFFLIANT SAYETH NOT



Scott F. Cate

Subscribed and Sworn To before me this the 10th day of February, 2000.



Notary Public for Utah

CERTIFICATE OF SERVICE

I, Carmen D. Minor, do hereby certify that on this 14th day of February, 2000, I have caused a copy of the foregoing *Ex Parte* filing to be served, via hand delivery or first class United States Mail, postage prepaid, upon the persons listed on the attached service list.


Carmen D. Minor

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